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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY,
*Petitioner,*

*vs.*

NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA,
*Respondents.*

## PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF

RALPH S. HARRIS,
WILLIAM W. OWENS,
ADAM M. BYRD,
*Attorneys for Petitioner.*

LEE J. GARY,
H. ALLEN LOCHNER,
WILLIAM F. KOEGEL,
*Of Counsel.*

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*Respondents.*

## PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

*To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:*

Your petitioner, UNIVERSAL OIL PRODUCTS COMPANY, prays that a writ of *certiorari* issue to the United States Court of Appeals for the Seventh Circuit to review three final judgments of that Court made and filed April 6, 1950, which judgments, so far as material here, reversed judgments of the District Court in favor of petitioner.

These three cases (Nos. 9902, 9903 and 9904 in the Court of Appeals) were commenced by petitioner in 1947

to recover from the defendant below (the former Collector of Internal Revenue for the First District of Illinois) federal income taxes paid to him by petitioner for the period from November 30, 1944 to December 31, 1946 on the ground that from and after November 29, 1944 petitioner was entitled to exemption therefrom under Section 101(6) of the Internal Revenue Code (26 U. S. C. Sec. 101[6]). The defendant appeared and filed answers taking issue upon the claim of exemption and asserting certain offsets. The United States, by leave of court, intervened to assert against petitioner certain alleged deficiency claims of income and excess profits taxes for the calendar years 1944, 1945 and 1946.

The three cases were tried together in the District Court (R. 956, 958, 960) and were consolidated and argued together in the Court of Appeals (R. 1059).

A certified transcript of the record in the cases, including the proceedings in said Court of Appeals, is furnished herewith in compliance with Rule 38 of this Court.*

## JURISDICTIONAL STATEMENT

Jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254(1). The final judgments, of which review is sought, were made and filed April 6, 1950.

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*Pursuant to stipulation among counsel for the parties, the original exhibits were not printed in the Court of Appeals but were physically lodged with the clerk of that court. Pursuant to similar stipulation between counsel for the parties, said exhibits, certified by the clerk of the Court of Appeals, have been filed with the Clerk of this Court and for the purpose of this petition have not been printed.

## SUMMARY AND SHORT STATEMENT OF MATTER INVOLVED

Petitioner was incorporated under the General Corporation Law of Delaware on January 27, 1932, and succeeded to the business of a South Dakota corporation of the same name (hereinafter referred to as "South Dakota"), organized in 1914 (R. 528, 652, 682-83; Exh. 120, R. 534; Exh. E, Rider F, R. 355; Exh. 31 accompanying Exh. 90, R. 343; Finding 43, R. 930). Petitioner's charter, like its predecessor's, authorized it, *inter alia*, to engage in research in chemistry, engineering and other scientific fields, in the acquisition, ownership and licensing of patented processes and in the rendering of engineering and other services and the designing of chemical plants (Exh. E, Rider F, R. 355).

Since its organization, petitioner has been, and until that time its predecessor was, engaged in the business of conducting research in the hydrocarbon field, devising refining processes and obtaining patents and licensing the use of processes and patents. Petitioner also sells certain chemicals called catalysts and inhibitors (R. 353, 457-59). It designs apparatus and plants covered by its processes and patents, gives its licensees specified protection against infringement claims, imparts to them its technical "know-how", assists them in breaking in their installations, including the training of their men, furnishes them periodical inspection and other services, renders to them special engineering services at moderate rates, and in general works in close cooperation with them (R. 353, 457-58, 667; Finding 43, R. 930-31).

Between 1931 and 1939 petitioner and its predecessor, South Dakota, adopted a program of expanding their facilities for serving their customers by a series of agreements, many of which also involved the settlement of existing patent litigation (R. 648-53, 664, 678-80).

In some of the agreements petitioner and South Dakota released past infringements of, and gave immunity against suit to, the other contracting parties (Exhs. 41, 42, 44, 46, 47, R. 552-54; R. 649-51) and received releases from past infringements of themselves and their licensees as well as covenants that their licensees would not be sued under the pyrolytic cracking patents of the other parties (*ibid.*). In other agreements, petitioner and its predecessor were granted affirmative licensing rights for both existing and future licenses with respect to all the grantors' patents relating to pyrolytic cracking and, in addition, were paid large sums of money for licenses and releases (Exhs. 40, 43, R. 552-54; R. 651-52, 678-80).

These and other agreements were made indiscriminately with petitioner's shareholders and noteholders and also with companies which were not and never had been security holders (R. 648-63, 692; Exhs. 40-50, 77, 78, NN, OO, PP, R. 552-54, 659, 661, 705).

By such agreements, as the evidence disclosed and as the District Court found, petitioner acquired strength and stability and the ability better to serve its customers (R. 650-56, 660, 661, 664, 667, 678-79, 694-700, 462-3; Findings 44, 45, R. 931). The agreements, it is obvious, were a large, if not the principal, contributing factor to the creation of the value of petitioner, which constituted the *res* of the trust established in 1944, known as The Petroleum Research Fund, which we are about to describe (*ibid.*).

On October 26, 1944, there were outstanding 120,200 shares of petitioner's stock and two series of its income notes of the aggregate principal amount of $8,500,000, with accrued interest, all of which were owned by seven oil companies (Exhs. 143-45, 148, 148A, R. 709, 720; R. 332). There were no other outstanding securities of petitioner of any kind (*ibid.*).

Between October 26, 1944 and November 29, 1944, inclusive, all of the outstanding stock and income notes of petitioner were transferred and delivered by way of gift to Guaranty Trust Company of New York, as Trustee, for scientific and educational purposes, pursuant to the terms of an irrevocable deed of trust dated October 26, 1944, creating "The Petroleum Research Fund" (R. 331-32; Exh. A, R. 331; Finding 20, R. 925-26).

Since November 29, 1944, the Trustee has been the sole owner of all of the outstanding stock and securities of petitioner and holds them for such scientific and educational purposes as to qualify the trust for exemption under Section 101(6) of the Internal Revenue Code (R. 331-36; Findings 21, 23-26, 33, 34, R. 926-29). It is conceded that said trust is exempt from federal taxation (Exh. B to Comp., R. 20; Ans., par. 3, R. 104-105; R. 333; Finding 35, R. 929).

The deed of trust (Exh. A) provides that the qualified recipient of the income shall be an American corporation or foundation (presently American Chemical Society) "organized and operated exclusively for charitable, scientific, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation" (Exh. A, Art. Third, R. 331; Finding

24, R. 926). American Chemical Society is organized by federal law as a non-profit scientific and educational institution (R. 338, 344-46). Its membership numbers more than 58,000 chemists and it has sections in all parts of the United States (R. 338, 341). The Society has been ruled by the Bureau of Internal Revenue to be entitled to exemption from federal taxation (R. 337-41, 344-49; Exhs. B, C, R. 339; Findings 27, 28, 31, 32, R. 928-29).

On November 16, 1945 petitioner amended its charter to incorporate therein the language of Section 101(6) of the Internal Revenue Code (Exh. E, Rider C, R. 355).

Between the date of the creation of the trust in 1944 and the date of trial, petitioner paid to the Trustee for the purposes of the trust approximately $675,000, and is presently under obligation to pay into the fund a minimum of $200,000 per year (R. 334, 340-41, 347-48; Finding 31, R. 929).

Early in 1946 petitioner filed with the Commissioner and Collector of Internal Revenue the prescribed exemption affidavit, claiming federal income tax exemption from November 30, 1944 under the provisions of Section 101(6) of the Internal Revenue Code. Thereafter, the Commissioner denied exemption on the ground that petitioner was conducting an ordinary business (Exhs. E, F, R. 355; Exh. C to Comp., R. 22; Findings 5-9, R. 924-25).

Petitioner, having paid taxes for 1944, 1945 and 1946, filed claims for refund of the portion thereof paid for the period beginning November 30, 1944 and ending December 31, 1946 and, after the required lapse of time, brought these actions to recover the same on the ground that it was exempt from the payment of income taxes for the period

in question under Section 101(6) of the Internal Revenue Code (26 U. S. C. Sec. 101[6]).

The requirements of Section 101(6), so far as material, are as follows:

(1) that taxpayer be a corporation;

(2) that it be organized exclusively for one of the named exempt purposes;

(3) that it be operated exclusively for one of the named exempt purposes;

(4) that no part of its net earnings shall inure to the benefit of any private shareholder or individual; and

(5) that no substantial part of its activity shall be carrying on propaganda, or otherwise attempting, to influence legislation.

The District Court, on consideration of the evidence, held that petitioner had satisfied the several requirements of Section 101(6) of the Internal Revenue Code (R. 925-31) and concluded that petitioner "is, and since November 29, 1944 has been, exempt from federal income taxes within the meaning of Section 101(6) of the Internal Revenue Code and * * * from federal excess profits taxes" (R. 947).

The defendant and the intervenor in the District Court (the respondents herein) appealed to the Court of Appeals for the Seventh Circuit and, as shown above, that court, by its final judgments made and entered April 6, 1950, reversed the District Court and held that petitioner was not entitled to such income tax exemption on the ground that petitioner was not "organized" or "operated" exclusively

for an exempt purpose (R. 1060-80). The Court of Appeals stated that in view of its conclusion in respect of these two matters it was unnecessary to consider whether or not any part of petitioner's net earnings could inure to the benefit of any private shareholder or individual or whether any substantial part of petitioner's activities related to lobbying (R. 1080).

In view of the failure of the Court of Appeals to consider the last two requirements for exemption, we assume that, at least pending determination by this Court, the following findings of the District Court are unaffected:

> "Since November 29, 1944 no part of the net earnings of plaintiff [petitioner] has been paid to, or has otherwise inured to the benefit of, any private shareholder or individual" (Finding 36, R. 929-30).
>
> "Since November 29, 1944 no substantial part of the activities of plaintiff [petitioner] has consisted of carrying on propaganda, or otherwise attempting, to influence legislation" (Finding 39, R. 930).

## QUESTIONS PRESENTED

1. Is petitioner exempt from federal income taxes under the provisions of Section 101(6) of the Internal Revenue Code?

2. Is petitioner entitled to a liberal construction of the exemption provisions of Section 101(6) of the Internal Revenue Code?

3. May a corporation, which is originally organized as a business corporation to be conducted for profit, subsequently become exempt when all of its stock and other securi-

ties, being the sole means by which its net earnings may be distributed, are irrevocably dedicated to a concededly exempt purpose?

4. Is such a corporation, upon the dedication of its stock and securities to an exempt purpose, organized exclusively for such an exempt purpose?

5. Is such a corporation, when in fact all distributions of its net earnings are made to an exempt trust, operated exclusively for an exempt purpose?

6. Does any part of the net earnings of petitioner inure, as a matter of law, to the benefit of a private shareholder or individual?

7. Were the activities of petitioner, to any substantial extent, the carrying on of propaganda, or otherwise attempting, to influence legislation?

8. Does the failure of petitioner to distribute all of its net earnings prevent it from being exempt?

9. Is the exemption, to which petitioner would otherwise be entitled, defeated by reason of the fact that it paid directors' fees or by reason of the fact that the trustee, under a concededly exempt trust, compensated itself out of the trust income for its services as such trustee?

10. Is not the factual situation, rather than any artificial formality, the criterion for determining compliance with the requirements of Section 101(6) of the Internal Revenue Code?

## REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

Exercise of the discretionary power of this Court to grant the writ of *certiorari* herein prayed for is asked upon the following grounds:

1. The Court of Appeals in the instant cases has rendered a decision in conflict with decisions of the Courts of Appeals for the Second, Fifth and Sixth Circuits, and the decision is believed to be in conflict with the law as laid down by this Court.

2. It would be in the public interest and result in the conservation of the time and labor of the courts for this Court to resolve the conflict.

3. Determination of the questions here presented is important in the proper administration of the revenue laws.

4. In determining that petitioner in the instant cases was not organized exclusively for an exempt purpose, the Court of Appeals has applied a criterion which is untenable and is in conflict with the decisions of other courts of appeals.

5. In determining that petitioner in the instant cases was not operated exclusively for an exempt purpose, the Court of Appeals has applied a criterion which is untenable, is in conflict with the decisions of other courts of appeals and is believed to be in conflict with the applicable decisions of this Court.

WHEREFORE, your petitioner respectfully prays that a writ of *certiorari* be issued out of and under the seal of

this Court, directed to the Court of Appeals for the Seventh Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record of all proceedings in the cases numbered and entitled on its docket Nos. 9902, 9903 and 9904, *Universal Oil Products Company, Plaintiff-Appellee,* v. *Nigel D. Campbell, Defendant-Appellant,* and *The United States of America, Intervenor-Appellant,* and that said judgments of the Court of Appeals for the Seventh Circuit may be reversed by this Court and that your petitioner may have such other and further relief in the premises as to this Court may seem just; and your petitioner will ever pray.

UNIVERSAL OIL PRODUCTS COMPANY,
Petitioner,

By: RALPH S. HARRIS,
WILLIAM W. OWENS,
ADAM M. BYRD,
*Attorneys for Petitioner.*

LEE J. GARY,
H. ALLEN LOCHNER,
WILLIAM F. KOEGEL,
*Of Counsel.*

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## BRIEF IN SUPPORT OF PETITION FOR A WRIT OF *CERTIORARI*

### THE OPINIONS OF THE COURTS BELOW

The opinion of the Court of Appeals in the instant cases is reported at 181 F. 2d 451. The opinion of the District Court is not reported, but is set forth at page 772 of the record. The District Court's findings of fact and conclusions of law are set forth at pages 923-955 of the record.

### JURISDICTION

The facts supporting the jurisdiction of this Court are set forth in the petition.

Cases believed to sustain the jurisdiction of this Court are as follows:

*Commissioner* v. *Korell*, U. S. , 18 U. S. L. W. 4409 (decided June 5, 1950);
*Reo Motors* v. *Commissioner*, 338 U. S. 442;
*Commissioner* v. *Phipps*, 336 U. S. 410;
*Trinidad* v. *Sagrada Orden*, 263 U. S. 578;
*Magnum Co.* v. *Coty*, 262 U. S. 159.

## STATEMENT OF THE CASE

The facts are sufficiently set forth in the petition.

## SPECIFICATION OF ERRORS

If the writ is granted, petitioner will urge that the Court of Appeals in the instant cases erred in the following respects:

1. In holding that petitioner was not exempt from federal income tax from November 30, 1944 to December 31, 1946, under the provisions of Section 101(6) of the Internal Revenue Code.

2. In holding that petitioner was not entitled to a liberal construction of the exemption provisions of Section 101(6) of the Internal Revenue Code.

3. In holding that petitioner was not organized exclusively for one of the exempt purposes specified in that section.

4. In holding that petitioner was not operated exclusively for one of the exempt purposes specified in that section.

5. In failing to hold that no part of the net earnings of petitioner inured to the benefit of any private shareholder or individual.

6. In failing to hold that no substantial part of the activities of petitioner was carrying on propaganda, or otherwise attempting, to influence legislation.

7. In holding that petitioner, which was originally organized as a business corporation for profit and which originally had private shareholders, might never thereafter be reorganized as an exempt corporation within the meaning of said section.

8. In holding that petitioner, although it was operated during the years under review as a business corporation for the profit of an exempt trust, could not meet the requirements of said section.

9. In holding that petitioner failed to meet the requirements of said section because, in order to acquire patent rights necessary for the successful operation of its business, it had, prior to the period here under review, conferred on various oil companies rights under petitioner's patents.

10. In holding that petitioner was not entitled to the exemption because it failed to distribute all of its net earnings.

11. In holding that petitioner was not entitled to the exemption because it paid directors' fees to its directors.

12. In holding that petitioner was not entitled to the exemption because, it was claimed, the board of directors had power to cause petitioner to issue additional shares of capital stock.

13. In holding that petitioner was not entitled to the exemption because the trustee of the concededly exempt trust, which owned all of petitioner's stock and securities, compensated itself out of the income of the trust for its services.

14. In holding that petitioner was not entitled to the exemption because it devoted a part of its earnings to the improvement of its plant and facilities and to reserves for liabilities.

## ARGUMENT

**THE DECISION OF THE COURT OF APPEALS HEREIN IS IN CONFLICT WITH THE DECISIONS OF THIS COURT AND OTHER COURTS OF APPEALS:**

**A. In holding that petitioner was not entitled to a liberal construction of the exemption provisions of the Internal Revenue Code.**

The Court of Appeals for the Seventh Circuit held that the Government is entitled to a strict construction of the exemption provisions of a tax statute (R. 1066-67). Other Courts of Appeals have held, however, that "Exemptions of income devoted to charity are begotten from motives of public policy and are not to be narrowly construed." *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776, 779; *Commissioner of Internal Reve-*

*nue* v. *Orton*, 6 Cir., 173 F. 2d 483, 486; *Home Oil Mill* v. *Willingham*, N. D. Ala., 68 F. Supp. 525, 530, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627.

**B. In holding that petitioner from and after November 29, 1944 was not organized exclusively for scientific and educational purposes.**

In the instant cases the Court of Appeals held that petitioner was not "organized" exclusively for any of the exempt purposes. It based this conclusion upon the fact that petitioner was originally organized as a business corporation for profit with private shareholders and conducted the ordinary business activities of a commercial enterprise. It concluded that, petitioner having been so organized, no subsequent change in its status could enable it to be regarded as "organized" exclusively for any exempt purpose (R. 1067-76).

In so holding, the decision of the Court of Appeals is in conflict with the decisions of other courts of appeals. *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776; *Willingham* v. *Home Oil Mill*, 5 Cir., 181 F. 2d 9; *accord, Home Oil Mill* v. *Willingham*, N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627; *Home Oil Mill* v. *Willingham*, N. D. Ala., 86 F. Supp. 568, *aff'd*, 5 Cir., 181 F. 2d 9.

In the leading case of *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue, supra*, taxpayer was incorporated under the New York Stock Corporation Law by one

Roche shortly before his death. Upon its organization, Roche conveyed his public bathing beach property to it in exchange for all of its capital stock. At all times thereafter it was engaged in the same general business activities for profit that Roche had theretofore carried on individually. During the remainder of Roche's life he alone owned the stock and the corporation operated the beach. It was his intention "to continue to operate the property so long as he should live; *and he did so, receiving all the income therefrom until his death*" (p. 777).*

Roche died leaving the stock to trustees for an admittedly exempt purpose. Thereafter, the trustees continued to operate the corporation without making any change in the corporate charter. On these facts, the court of appeals held that the corporation was exempt under Section 101(6), saying (p. 778):

> "As a question of fact, it seems clear that the corporation was organized and operated exclusively for charitable purposes; and the Board made no finding to the contrary. *It denied exemption on the theory that the stated purposes for which a corporation is organized must be found in its charter. We think this is too narrow a view.* Appeal of Unity School of Christianity, 4 B. T. A. 61, is in point. * * * No decision to the contrary has been called to our attention."

While the court accepted the view that Roche's motivation in organizing the corporation under the stock corporation laws was ultimately to use the company as a medium through which the charitable foundation could operate the property and collect the income after his death, it is also

*Italics supplied unless otherwise indicated.

true that Roche's intention was personally "to continue to operate the property so long as he should live" and, indeed, he as sole stockholder received "all the income therefrom until his death" (p. 777). Furthermore, he was at liberty at any time to change his mind as to the gift of the stock in his will. It was not till he died, leaving the stock *irrevocably* for an exempt purpose, that the corporation's status changed from that of an ordinary business tax-paying corporation.

*Home Oil Mill* v. *Willingham,* N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627, *supra,* is to the same effect. One Spight died leaving a gross estate which included all of taxpayer's stock. Taxpayer had been organized as a business corporation and had operated an oil mill and, until Spight's death, there was no evidence of an irrevocable intention to give the corporation's stock to charity. The residuary estate, *including all of the capital stock of taxpayer,* was bequeathed to W. R. Spight Religious and Charitable Trust, which was created by Spight's will for the ultimate benefit of eight admittedly religious, educational, charitable or eleemosynary institutions. The trustees were empowered to operate the business of the corporation and to make distributions to the eight beneficiaries.

In holding that the taxpayer corporation was exempt within the meaning of Section 101(6), the District Court said (p. 530):

> "The evidence discloses that from the date of its reorganization, which was prior to the tax year involved, all of its net earnings have been paid directly to charitable, religious and educational organizations exempt from the tax. Thus, its organization

> and operation, disassociated from provisions of the Spight will, hereinafter discussed, bring it clearly within the principle announced in Trinidad v. Sagrada Orden, etc., supra; Roche's Beach, Inc., v. Commissioner of Internal Revenue, supra; Debs Memorial Radio Fund v. Commissioner of Internal Revenue, 2 Cir., 148 F. 2d 948; Bohemian Gymnastic Ass'n Sokol of City of New York v. Higgins, 2 Cir., 147 F. 2d 774."

In a second case, *Home Oil Mill* v. *Willingham,* N. D. Ala., 86 F. Supp. 568, *supra,* the same judge, in again holding the taxpayer exempt, said of the *Roche's Beach* case (p. 569):

> "* * * it is highly significant that no court of equal authority has disputed it."

On appeal the Court of Appeals for the Fifth Circuit (181 F. 2d 9) affirmed and, in referring to the *Roche's Beach* case, observed (p. 10):

> "It would be difficult to frame legislation against the doctrine in Roche's Beach without at the same time changing the law as announced in Trinidad v. Sagrada Orden, 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458, and no one seems to want to do that.
>
> * * * * *
>
> "If it is possible for a religious, charitable, and educational trust to operate an industry through a corporate agency, and be exempt under Section 101(6) of Title 26 U. S. C. A., the appellant [Home Oil Mill] is entitled to such exemption."

Both law and reason require that the right of a corporation to be exempted under Section 101(6) of the Internal Revenue Code depend not upon the evanescent

form of its charter, but upon the historical fact of its irrevocable dedication to exempt use. *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776; *Commissioner of Internal Revenue* v. *Battle Creek,* 5 Cir., 126 F. 2d 405. If it be that the corporation is organized* and operated exclusively for an exempt purpose, that none of its net earnings inures to the benefit of any private individual or shareholder, and that no substantial part of its activities consists of carrying on propaganda, or otherwise attempting, to influence legislation, then, irrespective of the terms of its charter, it is entitled to exemption under the section in question.

Thus the charter in the *Roche's Beach* case was that of an ordinary business corporation without any provisions therein embodying a recitation of any intention of dedication to an exempt purpose.

Similarly, the charter in the *Battle Creek* case was granted under the general corporation laws of Florida. Yet the court held that (p. 406):

> "It is not unusual for charters of corporations to grant broad powers and privileges that are never intended to be used. That does not control the specific purposes of the incorporation."

Moreover, the charter in *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.,* 2 Cir., 148 F. 2d 948, was

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*In *Pub. Serv. Comm'n* v. *Rwy. Co.,* 146 Md. 580, 127 Atl. 112, the court, in interpreting Section 20a of the Interstate Commerce Act, which defined a carrier as "any *corporation organized* for the purpose of engaging in transportation by railroad subject to this act", stated (p. 584):

> "Giving the language its natural grammatical effect the word *'organized'* is used in that statute to describe the *present and existing* status of the corporation and not its status or condition *at some past time.*"

framed "as broadly" as that of any business corporation and so remained, although the by-laws were amended to forbid the declaration of dividends. Yet the court, citing the *Roche's Beach* case with approval, held that the corporation was exempt.

In view of the amendment of petitioner's charter in November, 1945 (p. 6, *supra*) to incorporate the exact provisions of Section 101(6) of the Internal Revenue Code, the Court of Appeals should have held petitioner exempt at least from the date of such amendment. In failing to do so, the holding of the Court of Appeals for the Seventh Circuit is in conflict with the holding of the Court of Appeals for the Fifth Circuit in *Willingham* v. *Home Oil Mill, supra.*

**C. In holding that petitioner was not operated exclusively for an exempt purpose.**

In the instant cases the Court of Appeals for the Seventh Circuit based its conclusion, *inter alia,* upon its holding that no company which is engaged in a commercial enterprise for profit can be said to be operated exclusively for an exempt purpose, no matter who its stockholders may be (R. 1076-80).

In so holding, the decision of the Court of Appeals is in conflict with decisions of other courts of appeals and of this Court. *Trinidad* v. *Sagrada Orden,* 263 U. S. 578; *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776; *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.,* 2 Cir., 148 F. 2d 948; *Bohemian Gymnastic Ass'n Sokol of City of N. Y.* v. *Higgins,* 2 Cir., 147 F. 2d 774; *Commissioner of Internal Revenue* v. *Orton,* 6 Cir., 173 F. 2d 483; *Hanover Imp. Soc.* v. *Gagne,* 1 Cir.,

92 F. 2d 888; *Home Oil Mill* v. *Willingham,* N. D. Ala., 86 F. Supp. 568, *aff'd sub nom. Willingham* v. *Home Oil Mill,* 5 Cir., 181 F. 2d 9.

An exempt organization obviously must have funds to further its program. Such an organization, it is recognized, need not be dependent on charitable contributions to carry on its work, but may itself own income-producing properties and engage in income-producing activities. The fact that such activities are competitive in nature and are engaged in solely to produce income does not remove the organization from the exempt category. The courts have uniformly held that it is not the *source* of the income which determines whether an organization is exempt, but its *destination* and the *purpose* for which it is obtained. *Ibid.; Home Oil Mill* v. *Willingham,* N. D. Ala., 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627.

Thus, in *Trinidad* v. *Sagrada Orden, supra,* plaintiff corporation, organized for religious purposes, received dividends, interest and rent from investments, loans and properties, respectively. The bulk of its income was derived from these sources and the balance from alms, profits from sale of stock and from sale of wine, chocolate and other articles supplied to churches and missions. Plaintiff's claim of exemption was contested on the ground that it was not "operated exclusively" for charitable purposes but that it was operated "also for business and commercial purposes in that it uses its properties to produce income, and trades in wine, chocolate and other articles" (p. 581).

This Court, in holding that plaintiff was exempt, pointed out that the statute recognized that a religious corporation might have a net income and yet remain exempt. The Court also noted that the statute said "nothing about the

source of the income, *but makes the destination* [*of the income*] *the ultimate test of exemption*" (p. 581). The Court, therefore, concluded that "the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain." Such benevolent activities, the Court observed, "cannot be carried on without money" which is generally "received from properties dedicated to their pursuit". Hence, according to this Court, "Making such properties productive to the end that the income may be thus used does not alter or enlarge the purposes for which the corporation is created and conducted" (p. 581).

Following the *Trinidad* decision is *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776, *supra,* where the plaintiff's sole activity was the operation of an extensive bathing beach for profit, described by the court as follows (p. 777):

> "There were 3,000 bath houses to be let to transient bathers; 34 employees were engaged during the summer; as many as 6,000 persons might patronize the beach on pleasant days; suits and towels were rented; caps, belts and shoes were sold; and restaurant, soda and candy concessions were given out. In 1931 income from the beach property, exclusive of rentals from the other real estate, was more than $85,000, and expenses, omitting taxes, ran to nearly $40,000."

In holding that the corporation was exempt under Section 101(6), despite the nature of its business, since the income therefrom was devoted to exempt purposes, the court stated (p. 778):

"This does not mean that to come within the exemption a corporation may not conduct business activities for profit. The destination of the income is more significant than its source. See Trinidad v. Sagrada Orden, 263 U. S. 578, 44 S. Ct. 204, 68 L. Ed. 458; Sand Springs Home v. Commissioner, 6 B. T. A. 198, 214; Appeal of Unity School of Christianity, 4 B. T. A. 61."

In *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.*, 2 Cir., 148 F. 2d 948, *supra*, plaintiff's sole activity was the ownership and operation of a radio station. From 1939 to 1942 its revenue from broadcasts was as follows (p. 950):

| "Year | Gross income from broadcasting | Commissions paid | Net Income |
|---|---|---|---|
| 1939..... | $284,294.41 | $52,855.47 | $ 9,221.69 |
| 1940..... | 323,834.16 | 52,955.36 | 30,700.57 |
| 1941..... | 290,385.69 | 55,631.10 | 6,053.68 |
| 1942..... | 294,466.11 | 50,411.44 | 7,449.18" |

In holding that plaintiff was exempt even though its income was principally derived from the selling of radio time in competition with other stations, the court said (pp. 951, 952):

"Nor is it fatal to exemption that substantially all of the petitioner's income is derived from commercial activities since the purpose of making profits has been to enable it to broadcast its educational, civic and cultural programs without charge.

* * * *

" * * * we think the petitioner was 'operated exclusively for the promotion of social welfare.' The purpose of its commercial broadcasts has been to obtain funds to enable it to broadcast its educational, civic and cultural programs without charge. Its

> aim has been only to make station WEVD self-supporting, and up to the end of 1940 the expenses of operation have exceeded receipts by some $37,000."

Similarly, in *Commissioner of Internal Revenue* v. *Orton*, 6 Cir., 173 F. 2d 483, *supra*, the testator bequeathed to a foundation established under his will a going business engaged in the manufacture of pyrometric cones. The purposes of the foundation were described in the will as follows (p. 484):

> "The first and principal purpose is to provide a stable and dependable organization for continuing the manufacture and sale of Standard Pyrometric Cones of the highest quality and most exact accuracy that is commercially feasible, at a reasonable price. The second and subsidiary purpose of this trust is to provide a Research Organization for the prosecution of studies and researches for overcoming technical and manufacturing difficulties, and for thus advancing the ceramic arts and industries in the United States."

In addition to the manufacture of cones "the foundation manufactured and sold the standard mixtures in powdered form to customers who made up their own testing devices". During the years 1934 to 1943, inclusive, the foundation made sales amounting to $637,596.06, from which net profits in the amount of $135,594.59 were realized. The foundation had at least two competitors.*

In holding that the foundation did not lose its exempt status under Section 101(6) because it engaged in com-

*Some of the facts appear from the opinion of the Tax Court, *Edward Orton, Jr. Ceramic Foundation*, 9 T. C. 533, 536, 537, 538.

mercial activity the Court of Appeals, following *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, and *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776, said (p. 486):

> "A business does not operate in vacuo—it is related to some objective. With the ordinary business man, it is run for profit and the profits serve his needs. Here the business, which in itself Orton deemed basic for good ceramics, produced profits to be plowed back into the furtherance of research and study in that field. We think that the Commissioner's contention that the taxpayer was engaged in an active, competitive business for profit and that therefore the enterprise could not be considered as exclusively one for scientific or educational purposes is answered by the opinion in Trinidad v. Sagrada Orden de Predicadores, 263 U. S. 578, 44 S. Ct. 204, 205, 68 L. Ed. 458, wherein the statute was construed."

Once petitioner's stock and securities had been irrevocably transferred to a trustee for scientific and educational purposes, petitioner ceased to be an organization whose "net earnings" could in any way benefit a private shareholder or individual. All net earnings thereafter were necessarily dedicated to the public good.

In *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776, the court expressly held that a "feeder" corporation, such as petitioner here, could be exempt under Section 101(6), stating (p. 779):

> "No reason is apparent to us why Congress should wish *to deny exemption to a corporation organized and operated exclusively to feed a charitable purpose when it undoubtedly grants it if the corporation*

*itself administers the charity.* We think the language is adequate to describe both types."

*Home Oil Mill* v. *Willingham,* N. D. Ala. (two cases), 68 F. Supp. 525, *app. dism'd* on Government's motion, January 9, 1946, C. C. H. Fed. Tax, 1950 Index, 20,627, and 86 F. Supp. 568, *aff'd,* 5 Cir., 181 F. 2d 9, were also almost identical with the cases before this Court and held to the same effect as in *Roche's Beach.*

Petitioner's agreements (p. 4, *supra*), which the Court of Appeals stressed, obviously do not distinguish the instant cases from those just discussed. The corporations in those cases, like petitioner, necessarily had contractual commitments, entered into in the course of their businesses, and outstanding at the time their net earnings were dedicated to an exempt purpose. Nevertheless they were held to have been operated exclusively for an exempt purpose despite such commitments.

The opinion below ignores reality. Any contract is presumably beneficial to each of its parties. An agreement by a church to purchase an organ, or by a school to retain a professor, presumably benefits the organ maker and the professor. Would anyone contend, however, that the institutions thereby ceased to be operated for an exempt purpose?

So here, even if it be assumed that the agreements benefited those with whom petitioner contracted, they remained peculiarly beneficial to petitioner. Without them, as we have said (p. 4, *supra*), it is obvious that petitioner could not have grown and prospered; with them, the value of petitioner, the *res* of the trust created in 1944, was increased. Under these circumstances, we submit, the Court of Appeals opinion and judgments are clearly in conflict with the prece-

dents. See particularly, *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue,* 2 Cir., 96 F. 2d 776; *Commissioner of Internal Revenue* v. *Orton,* 6 Cir., 173 F. 2d 483; *Debs Memorial Radio Fund* v. *Commissioner of Int. Rev.,* 2 Cir., 148 F. 2d 948; *Hanover Imp. Soc.* v. *Gagne,* 1 Cir., 92 F. 2d 888.

## CONCLUSION

For the foregoing reasons it is submitted that the petition should be allowed and that the aforesaid judgments of the Court of Appeals for the Seventh Circuit in the instant cases should be reviewed and reversed.

Respectfully submitted,

RALPH S. HARRIS,
WILLIAM W. OWENS,
ADAM M. BYRD,
*Attorneys for Petitioner.*

LEE J. GARY,
H. ALLEN LOCHNER,
WILLIAM F. KOEGEL,
*Of Counsel.*

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